

REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL LEGISLATURE AND THE COUNCIL ON MAKHUDUTHAMAGA LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Makhuduthamaga municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with South African Generally Accepted Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. The accounting records of the municipality did not in all instances indicate the location of the assets included in the financial statements. In instances where the location was indicated, there were discrepancies between the designated location and the actual location of the assets. As a result, I was unable to physically verify the assets included in the financial statements. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence and rights pertaining to the property, plant and equipment balance of R5 784 484 in the financial statements.
5. Included in property, plant and equipment, as disclosed in note 3 to the financial statements, is infrastructure assets amounting to R32 061 454 which does not belong to the municipality. Furthermore, an adjustment amounting to R1 834 514 was also made to the infrastructure asset balance for which insufficient appropriate audit evidence could be provided. With reference to paragraph 4 above, I could not determine the effect on property, plant and equipment, other account balances and transactions contained in the financial statements.

Inventory

6. There was no system of control over inventory records on which I could rely for the purpose of my audit and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all inventory additions and issues were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of inventory of R477 345 (2010: R114 220) disclosed in note 4 to the financial statements.

Impairment for doubtful debt

7. The impairment for doubtful debt balance of R6 614 773 (2010: R2 566 229), as disclosed in note 6 to the financial statements, does not agree to the balance of R4 657 785 per the underlying accounting records. The entity did not reconcile the difference of R1 956 987 between the financial statements and the underlying accounting records. Consequently, the impairment for doubtful debt is overstated by R1 956 987. I was unable to determine the effect on the other account balances or classes of transactions contained in the financial statements.

Trade and other receivables

8. As disclosed in note 5 to the financial statements, the corresponding figure for the value-added tax (VAT) receivable has been restated to R10 133 593 in order to address a prior year misstatement. Sufficient supporting documentation was not available for the restatement. Furthermore, there is an unexplained difference of R1 780 368 between the amount disclosed in the financial statements and my recalculated amount of R14 868 723. The municipality's records did not permit the application of alternate audit procedures. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself as to the existence, completeness, valuation and rights and obligation of the VAT receivable corresponding figure of R16 667 092.

Trade and other payables

9. Trade and other payables as disclosed in note 9 to the financial statements include accrued leave pay amounting to R969 001 (2010: R811 234) for which leave records were not accurately maintained. The municipality's records did not permit the application of alternate audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of this amount in the financial statements. The corresponding effect on employee related costs could also not be determined.
10. The municipality is required to estimate the provision for bonus at year-end in terms of the Standards of Generally Recognised Accounting Practice, GRAP 19, *Provisions, contingent liabilities and contingent assets*. The municipality did not determine the provision at year end. Consequently, trade and other payables are understated and accumulated surplus is overstated by an unquantifiable amount.
11. Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed upon with the supplier, including amounts due to employees. The entity accrued for invoices in respect of goods and services amounting to R5 413 093. Sufficient appropriate audit evidence could not be provided by the municipality to confirm whether the goods and services were received at or prior to year-end. The municipality's records did not permit the application of alternate audit procedures. Consequently, I was unable to determine the valuation and allocation of and obligation pertaining to this amount.

12. Included in the corresponding figure of note 9 to the financial statements, is retentions amounting to R6 512 329. Adjustments were effected to this balance to address prior year misstatements. My recalculation of the prior year retentions balance amounted to R5 597 068 and no explanations could be provided by the municipality for the difference of R915 261. Consequently, I was unable to satisfy myself as to the existence and valuation and allocation of the accounts payables corresponding figure of R6 826 121.

Revenue

13. Standards of Generally Recognised Accounting Practice, GRAP 9, *Revenue from exchange transactions* defines revenue as a the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners. The municipality incorrectly included in revenue VAT refunds from the South African Revenue Services (SARS) amounting to R2 988 090. The accumulated surplus and VAT receivable balance are consequently overstated by this amount.

Leases

14. Included in the amount of R4 085 519 disclosed in note 22 to the financial statements, are operating lease transactions amounting to R631 877 for which no lease agreements or appropriate supporting documentation could be provided. The municipality's records did not permit the application of alternate audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy and classification of this amount included in the financial statements.

Contingent liabilities

15. As required by the Standards of Generally Recognised Accounting Practice, GRAP 19, *Provisions, contingent liabilities and contingent assets* the municipality has disclosed contingent liabilities amounting to R355 840. The municipality was unable to provide sufficient appropriate audit evidence to satisfy me as to the completeness and valuation of this amount disclosed in note 26 to the financial statements.

Disclaimer of opinion

16. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

17. I draw attention to the matters below. My opinion is not modified in respect of this matter:

Restatement of corresponding figures

18. As disclosed in note 28 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during 2011 in the financial statements of the Makhuduthamaga municipality at, and for the year ended, 30 June 2010.

Unauthorised expenditure

19. As disclosed under note 31 of the financial statements, the municipality incurred unauthorised expenditure of R13 889 414 due to funds expended for purposes which were not in accordance with the vote.

Irregular expenditure

20. As disclosed under note 33 of the financial statements, the municipality incurred irregular expenditure amounting to R9 355 131 as a result of contravention of supply chain management laws and regulations.

Additional matter

21. I draw attention to the matter below. My opinion is not modified in respect of this matter:

22. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

23. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives**Usefulness of information**

24. The reported performance information was deficient in respect of the following criteria:

- Measurability: Indicators are not well-defined and verifiable, and targets are specific, measurable and time-bound

25. The following audit findings relate to the above criteria:

- For the infrastructure development and service delivery programme, 57% of the planned and reported indicators were not clear, as unambiguous data definition were not available to allow for data to be collected consistently.

Reliability of information

26. The reported performance information was deficient in respect of the following criteria:

- Validity: Actual reported performance has occurred and pertains to the entity
- Accuracy : Amounts, numbers, and other data relating to reported actual performance have not been recorded and reported appropriately
- Completeness: All actual results and events that should have been recorded have been included in the annual performance report.

27. The following audit findings relate to the above criteria:

- For the infrastructure development and service delivery programme, the validity, accuracy and completeness of 37% of the reported indicators could not be established as sufficient appropriate audit evidence and relevant source documentation could not be provided.
- The key performance indicators did not include all general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the Municipal Systems Act

Compliance with laws and regulations

Budget

28. The municipality incurred expenditure incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimer of audit of opinion.

Expenditure management

30. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
31. The accounting officer did not take reasonable steps to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act.

Procurement and contract management

32. Contracts were modified to the extent that competitive bidding processes were being circumvented contrary to the requirement of a fair supply chain management system in section 112 of the MFMA

Asset management

33. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets as required by section 63(2)(c) of the MFMA.

INTERNAL CONTROL

34. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

- The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls
- The accounting officer did not implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored
- The accounting officer did not establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes, and responsibilities
- The accounting officer did not develop and monitor the implementation of action plans to address internal control deficiencies
- The accounting officer did not establish an IT governance framework that supports and enables the business, delivers value and improves

Financial and performance management

- The chief financial officer did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting
- The chief financial officer did not implement controls over daily and monthly processing and reconciling of transactions
- The chief financial officer did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information
- The accounting officer did not review and monitor compliance with applicable laws and regulations
- The accounting officer did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

Governance

- The accounting officer did not implement appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored

- The accounting officer did not ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively
- Those charged with governance did not ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor-General
Polokwane

30 November 2011



AUDITOR-GENERAL
SOUTH AFRICA

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